



SBA West Virginia District Office
320 West Pike Street, Suite 330
Clarksburg, WV 26301
304-623-5631

7(a) Loan Underwriting

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Thank you!



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We would like to thank Gary Griffin for his time on this webinar and providing information regarding his experience in lending and working on SBA loans from his perspective.

All opinions, conclusions, and/or recommendations expressed herein are those of the presenter(s) and do not necessarily reflect the views of the SBA.



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7(a) Loan Underwriting

December 2015

Level: Basic

Presenter:

Gary E. Griffin – Capital Growth Solutions, LLC

Overview

- * The SBA Application
- * Front-end best practices
- * Critical “Must do’s” in a SBA credit memo
- * SBA credit memo format
- * Financial statement analysis
- * Calculating global cash flow
- * Reviewing a business and personal tax return
- * Calculating adequate working capital
- * SBA questions/Screen-out letters

What we will do

- * BASIC review of processes and procedures which help us in the submission process
- * Provide BEST PRACTICES from our years of experience.

What we will NOT do

- * Address every possible scenario
- * Review the SOP
- * Do advanced “PLP” training

Application

- * SBA One
- * Learn the website
- * Software Vendors
- * LSP's
- * Your SBA District Offices
- * NAGGL

Application

- * Forms 1919 and 1920
- * SBA form 912
- * Debt schedule
- * Credit Memo
- * Business valuations
- * IRS Verifications
- * CAVIRS

Front-End Best Practices

- * **BIGGEST TIP:** If you do not have it already, go ahead and spend the \$300 to purchase full Adobe. It has significantly cut back on unnecessary screen outs due to the fact that we can create the 10 tab submission file and label everything the way we would like it to be labeled. If you do not do this a person at the SBA will re-label your documents and create the 10 tab submission file for you before this gets to a rep. Unfortunately when they do this items are mislabeled or deemed unimportant and items that were sent in do not make it to the SBA rep's desk and they show up on a screen out. We have eliminated this problem by spending the extra 20min and creating and labeling our own 10 tab submission file.

Must Do's in the SBA credit memo

Make the memo easy to follow! You do not want the SBA rep that is reviewing the memo guessing on anything. Some tips:

1. Always breakdown Working Capital uses. If you do not, this will come back in a screen out
2. List debt(s) to be refinanced and include the following:
 - Term
 - Original Purpose
 - Secured by?
 - Current Payment
 - Proposed Payment & Savings
3. If equity injection is required, always verify funds are available prior to submission and make the statement in the memo
4. Clearly state interest rate, any adjustment periods, and payment

MD - Continued

- * Must include statement regarding 4506T: “Prior to submission a 4506T was sent in on the business. The tax transcripts were received and the tax returns verified **for the years 2012, 2013, 2014.**”
- * Recently the SBA reps have asked us to state the years that were verified in our statement rather than just saying returns were verified.

MD - Continued

- * Include what SOP was in use at the time of submission: “SOP 50 10(h) utilized at time of submission.”
- * As SOP’s are constantly evolving, it is good to note what SOP is being used in case the loan ever needs to be revisited for any reason i.e. liquidation

MD - Continued

Collateral: After listing collateral, make one of 3 statements:

* 7(a):

1. All available Collateral has been taken.
2. The loan is considered fully secured by the above collateral.

* Small Loan:

1. All collateral has been taken in accordance with similarly-sized non-SBA guaranteed commercial loans as stated in the SOP 50 10(h) found on page 166.

MD - Continued

- * If business plan is involved, memo must include analysis of business plan.
- * Must include statement that the business plan was reviewed and found acceptable. Must then list pros and cons in the analysis.

MD - Continued

- * Credit Analysis for Small Loans:
- * Even though it is not required the Bank must still be able to show it is making a prudent lending decision, so go ahead and do it. However, even if an analysis is done the SBA has recently required the following statements in the memo:
 1. The equity and pro forma debt-to-worth ratios were reviewed and acceptable to the Bank's policies and procedures.
 2. State personal financial statement and business financials were reviewed and consistent with the Bank's similarly-sized non-SBA commercial loans.

1919

- * Must be filled out by all owners holding 20% or more ownership, officers/directors (does not matter if they hold less than 20% ownership; if they are listed as an officer or director they MUST fill out the 1919), key employees, and any and all guarantors.
- * Does not have to be filled out by a Spouse that is only being pulled in as a partial guarantee due to a shared ownership in personal residence.

1920

- * Double Check interest rate and term and use of proceeds with credit memo.

Etran Sign Up

- * Sign up for a username and password. You are NOT finished after this.
- * Once you are signed in you must select the functions your institution needs (most lenders just need Lending and Servicing). You must input your location ID in these fields and press save. The SBA will then take 2 to 3 days to approve your use of Etran.

Etran Submission

- * Should only take 15min.
- * Double Check interest rate and term and use of proceeds with credit memo and SBA Form 1920.
- * Once you have entered Owner/Guarantor information you are finished. DO NOT include any business financial information.
- * Upload 10 tab submission file prior to submitting.
- * For Small Loans, check credit score (we usually do this early in the underwriting process to see if a loan request “scores” or not). If a loan does not score you can still submit regular 7(a), but regular 7(a) guidelines will apply such as outside collateral must be taken if available to fully secure the loan.
- * Once everything is complete and the 10 tab submission file is uploaded, press submit. If for any reason a required field was skipped, the system will direct you to what field was skipped and state “Application in Process”. Once any skipped fields have been filled out press submit again until the system states the loan request was formally received and in Reviewer Stage.

LINKS

- * Here is the link to the SBA Forms where a Lender can find the 1919 and 1920:
- * <https://www.sba.gov/category/type-form/small-business-forms/miscellaneous-forms>
- * Here is the link to the SBA suggested Debt Schedule:
- * https://www.sba.gov/sites/default/files/forms/tools_sbf_sba202.pdf
- * Here is the link to the 10 tab submission template:
- * [https://www.sba.gov/sites/default/files/files/LGPC%20Submission%20Template%20\(Tabs%201-10\)_20121219.pdf](https://www.sba.gov/sites/default/files/files/LGPC%20Submission%20Template%20(Tabs%201-10)_20121219.pdf)

Credit memo format

I. Application Information:

- * Borrower
- * Legal Name
- * Address
- * NAICS Code
- * Industry
- * Franchise (if applicable)
- * Loan Amount
- * Processing Method
- * Guaranty %

CM - Continued

II. Executive Summary: Start by telling the story!

- * Use of Proceeds
- * Description of Project
- * Outline Project Request
- * State Term, Interest Rate, Payment
- * State Injection (if applicable)

CM - Continued

III. Collateral Analysis

- * List Collateral, Value, Liquidation %, and Net Value

IV. Business Operations & History

- * Detailed Analysis of Business
- * Analysis of Business Plan (if applicable)

V. Management & Guarantors

- * Detail Management Experience

CM - Continued

VI. Financial Analysis

- * Balance Sheet Analysis including Pro Form Balance Sheet
- * Repayment Ability – Cash Flow
- * Historical as well as projected (if applicable)
- * Include interest rate shock and breakeven analysis
- * Global DSC

CM - Continued

VII. Guarantor Analysis

* For each owner/guarantor:

1. Personal Financial Statement Analysis
2. Historical Personal Tax Returns Analysis
3. Credit Report Analysis
4. Personal Cash Flow Analysis

CM - Continued

VIII. SBA Specific Questions

- * Credit Elsewhere
- * Size Standard
- * Debt Refinancing specific questions

IX. Summary

- * Signed approval by Bank Representative

Global Debt Service

SBA SOP 50 10 5(h) states

Lenders must demonstrate the Small Business Applicant's ability to repay the loan from the cash flow of the business by documenting the following:

- * The small business applicant's debt service coverage ratio must be equal to or greater than 1.15 on a historical and/or projected cash flow basis
- * Global cash flow analysis that includes assessment of impact on cash flow to/from any affiliate business.

Global Debt Service - 2

The SBA does not formally dictate the definition of Global Cash Flow, but it should include

- * Income/loss from affiliated companies,
- * Adjustments for inter-company transactions,
- * Personal financial needs of all guarantors,
- * Analysis of both cash based and accrual based statements where appropriate,
- * An explanation of any excluded debt (debt to be placed on standby, debt being paid off within a short time period, etc...).

Basic Debt Service Calculation

Debt Service Calculation w/Standard Addbacks

Revenue	\$1,484,673
Net Income	\$130,307
+ Rent	\$180,000
+ Interest	\$23,354
+ Depreciation/Amortization	\$23,354
+ Officer's Salary	\$130,000
- Officer Draw/New Owner Comp.	(\$108,000)
Cash Available to Service Debt	\$379,015
Projected Debt Service	\$200,000
Excess Cash Flow	\$179,015
Debt Service Coverage Ratio	1.90

Global Debt Service

* Global Debt Service Sample

	2010	2011	2012	2013
Personal Cash Flow-Guarantor #1	\$70,873	\$85,152	\$81,506	\$81,506
Personal Cash Flow-Guarantor #2	\$129,756	\$126,141	\$171,274	\$171,274
Personal Cash Flow-Guarantor #3	\$62,688	\$5,137	\$24,294	\$24,294
EBITDA - OC	\$642,715	\$711,714	\$648,611	\$583,259
EBITDA - Affiliate #1	\$193,652	\$219,849	\$347,329	\$343,817
EBITDA - Affiliate #2	\$118,028	-\$75,196	\$283,693	\$214,009
Total Existing Cash Flow	\$1,217,712	\$1,072,797	\$1,556,707	\$1,418,159
Personal Debt-Guarantor #1	\$304,392	\$304,392	\$304,392	\$304,392
Personal Debt-Guarantor #2	\$19,920	\$19,920	\$19,920	\$19,920
Personal Debt-Guarantor #3	\$44,148	\$44,148	\$44,148	\$44,148
Existing Debt-OC	\$89,124	\$89,124	\$89,124	\$89,124
Existing Debt-Affiliate #1	\$178,920	\$178,920	\$178,920	\$178,920
Existing Debt-Affiliate #2	\$188,580	\$188,580	\$188,580	\$188,580
Proposed New Loan	\$203,364	\$203,364	\$203,364	\$203,364
Total Debt	\$1,028,448	\$1,028,448	\$1,028,448	\$1,028,448
Global Debt Service Coverage	1.18	1.04	1.51	1.38

Definitions

OCF-Operating Cash Flow = EBITDA

DS-Debt Service = P+I of all business debt including the subject loan

DSCR- Debt Service Coverage Ratio= OCF/DS

Unfunded Capital Expenditures-the amount of all Capital Expenditures less any Capital Expenditures funded by Permitted Debt, Subordinated Debt or by the proceeds of any equity issue of the Borrower

Tax Returns

Business Tax Returns

- * Other Expenses (Statement)
- * M-1 and M-2 Adjustments
- * Year-to-Year comparison
- * K-1s

Personal Tax Returns

- * Schedule C Income
- * Recognizing Potential Affiliates

Adequacy of Working Capital

This is a key component to the credit decision and one that is scrutinized in repurchases and audits. The lender must determine and justify the adequacy of working capital in a loan request. Simply stating that the business is a cash business or that the principals have additional cash if needed is not sufficient. What is the cash cycle of the business? How much time will pro forma working capital support the business? How much availability is there in other LOCs?

These questions must be answered and the amount of working capital in the loan supported.

Working Capital Analysis

Steps to determining adequacy of working capital for non-cash businesses.

1. Determine the cash expenses of the business
2. Calculate the cash needs of the business
3. Determine what sources will support the cash needs

Working Capital Analysis Calculations

Determining Cash Expenses

$$\begin{array}{r} \text{Net Sales} \\ - \text{Net Income} \\ - \text{Depreciation/Amortization} \\ \hline \text{Cash Expenses} \end{array}$$

Calculating Cash Needs

$$(\text{Cash Expenses}/365) \times \text{Cash Cycle in Days}$$

Calculating Cash Cycle Days

$$\begin{array}{r} \text{A/R Days} \\ + \text{Inventory Days} \\ - \text{A/P Days} \\ \hline \text{Cash Cycle Days} \end{array}$$

Working Capital Needs

Scenario 1 – Working Capital Needs

Assumptions

* Net Sales	\$2,000,000
* Net Income	\$50,000
* Depreciation	\$75,000
* A/R Days	45
* Inventory Days	35
* Payable Days	30

Continued

Determining Cash Expenses

	\$2,000,000	Net Sales
-	\$ 50,000	Net Income
-	\$ 75,000	Depreciation/Amortization
	<hr/>	
	\$1,875,000	Cash Expenses

Calculating Cash Needs

$$\begin{aligned} & (\text{Cash Expenses}/365) \times \text{Cash Cycle in Days} \\ & \$1,875,000/365 \times 50 = \$256,849.32 \end{aligned}$$

Calculating Cash Cycle Days

	45	A/R Days
+	35	Inventory Days
-	<hr/>	<hr/>
	30	A/P Days
	<hr/>	
	50	Cash Cycle Days

Working Capital Sufficiency Cash Businesses

Calculating monthly working capital needs of cash businesses

		Annual COGS	
+		Annual Operating Expenses	
+		Owner's Draw Requirements	
-		Owner's Salary	
+		Non-recurring Expenses	
-		Depreciation/Amortization	
=		Annual Operating Costs/12	
	\$442,000	Annual COGS	
+	\$286,000	Annual Operating Expenses	
+	\$ 85,000	Owner's Draw Requirements	
-	\$ 40,000	Owner's Salary	
+	\$ 0	Non-recurring Expenses	
-	\$ 18,000	Depreciation/Amortization	
=	\$755,000 annual or \$62,917 monthly	Operating Costs	

Definition of Terms

A/R turnover	Sales divided by Accounts Receivable		
Days A/R	365 divided by A/R Turnover		
Inventory turnover	COGS divided by Inventory		
Days inventory	365 divided by Inventory Turnover		
A/P turnover	COGS divided by Accounts Payable		
Days A/P	365 divided by A/P Turnover		

Contact

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